84-799 (1)

No.

Office - Supreme Court, U.S.
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ALEXANDER L. STEVAS,
CLERK

In The

Supreme Court of the United States

October Term, 1984

M. FRENVILLE CO., INC. and RUDOLPH F. FRENVILLE, SR.,

Petitioners,

vs.

AVELLINO & BIENES, a Partnership,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTION PRESENTED FOR REVIEW

Did the United States Court of Appeals for the Third Circuit err in its determination that the automatic stay provisions of Section 362 of the Bankruptcy Code (11 U.S.C. §362) were inapplicable to the matter on appeal due to the fact that the claim of respondent arose after the commencement of the involuntry proceedings under Chapter 7 against the petitioners herein?

PARTIES TO THE PROCEEDING BELOW

1. Petitioners, M. Frenville Co., Inc. and Rudolph F. Frenville, Sr., are represented by Lehman & Wasserman, P.C., 225 Millburn Avenue, P.O. Box 311, Millburn, New Jersey 07041, and counsel of record are Myron S. Lehman, Esq. and Steven Z. Jurista, Esq.

2. Respondent, Avellino & Bienes, a Partnership, is represented by McDonough, Murray & Korn, Esqs., 555 Westfield Avenue, P.O. Box "O", Westfield, New Jersey 07091, and counsel of record is Jay Scott MacNeill, Esq.

3. Charles A. Stanziale, Jr., Interim Trustee for the Debtor Estates of M. Frenville Co., Inc., Rudolph F. Frenville, Sr. and Rudolph F. Frenville, Jr., is represented by Schwartz, Tobia & Stanziale, Esqs., 22 Crestmont Road, Montclair, New Jersey 07042, and counsel of record is Ben H. Becker, Esq.

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No.

In The

Supreme Court of the United States

October Term, 1984

M. FRENVILLE CO., INC. and RUDOLPH F. FRENVILLE, SR.,

Petitioners,

vs.

AVELLINO & BIENES, a Partnership,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

OPINIONS BELOW

On September 17, 1984 the United States Court of Appeals for the Third Circuit filed its opinion in the instant matter. Said matter was argued before that court on June 15, 1984. A notice was issued by the United States Court of Appeals in lieu of a formal mandate on October 11, 1984.

The Hon. Dickinson R. Debevoise, Judge of the United States District Court for the District of New Jersey rendered an oral opinion on September 26, 1983. The order of the court was filed on October 6, 1983.

The Hon. D. Joseph De Vito, United States Bankruptcy Judge sitting at Newark, New Jersey filed an opinion in this matter on June 27, 1983. An order of the court was subsequently entered.

STATEMENT OF JURISDICTION

Jurisdiction of this Court is conferred by the provisions of 28 U.S.C. §1254(1), on the grounds of the existence of a conflict between the decisions of the United States Court of Appeals for the Third Circuit and the courts below, the United States District Court for the District of New Jersey and the United States Bankruptcy Court for the District of New Jersey. There also exists an issue of public importance, being a final determination as to the interpretation of the language found in the provisions of Section 362 of the United States Bankruptcy Code, the automatic stay provisions.

STATUTES INVOLVED

Two sections of the United States Code are reviewed herein, together with various subsections thereof. The first such section is Section 362 of the Bankruptcy Code, 11 U.S.C. §362. Said section is extremely lengthy, and is reprinted in its entirety in the Appendix annexed hereto and made a part hereof, but for the purposes of this petition, the pertinent subsections appear below:

> "§362. Automatic Stay.
>
> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under

section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3), operates as a stay, applicable to all entities, of--

> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the commencement of a case under this title, or to recover a claim against the debtor that arose before the commencement of a case under this title; . . .
>
> (3) any act to obtain possession of property of the estate or of property from the estate; . . .
>
> (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; . . . ."

Also applicable to the argument contained in the within petition are subsections of Section 502 of the Bankruptcy Code, which section is also reprinted in its entirety in the Appendix annexed hereto and made a part hereof. The pertinent subsections of that section are:

> "§502 Allowance of claims or interests.
>
> (c) There shall be estimated for purpose of allowance under this section--

> (1) any contingent or unliquidated claim, fixing or liquidation of which, as the case may be, would unduly delay the closing of the case; or
>
> (2) any right to an equitable remedy for breach of performance if such breach gives rise to a right to payment. . . ."

STATEMENT OF THE CASE

Respondent Avellino & Bienes (hereinafter referred to as "A & B") is a certified public accounting firm which maintains its office in New York City. Said firm prepared financial statements on behalf of the corporate debtor, your petitioner herein, M. Frenville Co., Inc. (hereinafter referred to, collectively with Rudolph Frenville Sr., as "Frenville"). Said financial statements were prepared for the years ending August 31, 1978 and August 31, 1979 and were submitted to the Chase Manhattan Bank, N.A., *et al.* (hereinafter referred to as the "Bank").

An involuntary petition under Chapter 7 of the Bankruptcy Code was filed against the corporate debtor on July 8, 1980 and, subsequent thereto, an order for relief was entered by the Bankruptcy Court. Involuntary petitions under Chapter 7 were also filed against Rudolph F. Frenville, Sr. and Rudolph F. Frenville, Jr. on January 21, 1981, and those orders for relief were entered by the court on February 20, 1981.

The Bank commenced an action in the Supreme Court of the State of New York on November 16, 1981, which action was directed against A & B, the respondent herein (Appendix H, 63a). The Bank charged A & B with recklessness in the performance of its accounting duties, and with negligence in connection with the preparation of the audited financial statements for Frenville and submitted to the Bank.

On January 10, 1983 A & B instituted suit in the Bankruptcy Court against Frenville, by way of a complaint seeking the vacation of §362 automatic stay provisions of the Bankruptcy Code. Said complaint further sought permission to include Frenville as a third-party defendant in the New York action, and was based upon a claim for indemnification and/or contribution and compensatory as well as punitive damages for any damages that might be assessed against A & B by the Bank. Respondent further alleged that any false information that was contained in said financial statements was supplied by Frenville and, as such, created the basis for the action brought by A & B in the Bankruptcy Court.

In its opinion rendered on June 22, 1983 the Bankruptcy Court held that the §362 automatic stay provisions of the Code were applicable to the situation before it, and should remain in full force and effect (Appendix E, 50a). The court indicated that the claims of A & B against Frenville were based upon actions which had taken place prior to the commencement of the bankruptcy proceedings and, therefore, the automatic stay would not be vacated and the requested relief denied.

A & B filed a notice of appeal to the District Court on July 1, 1983 wherein it sought reversal of the Bankruptcy Court's ruling. In its Statement of Issues, A & B alleged that the lower court had overlooked and/or ignored the fact that in the action then pending in the Supreme Court of the State of New York, discovery was not possible because of the very nature of the action, *e.g.*, a design to conceal fraudulent activity. A & B further alleged that the Bankruptcy Court had failed to differentiate between the burden of the estate in defending the action, and the burden placed upon the individual debtors in the same defense.

On October 6, 1983 the District Court entered an order affirming the lower court's ruling (Appendix C, 31a). The order was entered subsequent to an oral decision which noted that the

purpose of the action instituted by A & B was solely to reach the debtors' assets, and as such, was in direct violation of the §362 automatic stay provisions of the Bankruptcy Code (Appendix B, 30a).

On November 2, 1983 A & B filed its notice of appeal to the United States Court of Appeals for the Third Circuit. In its Record on Appeal and Statement of Issues, respondent alleged that the District Court erred in its determination that the §362 automatic stay provisions of the Bankruptcy Code were applicable to the action before it. In its opinion filed on September 17, 1984 the Court of Appeals reversed the District Court's affirmance of the Bankruptcy Court's ruling that the §362 stay was applicable and that A & B were effectively barred from including Frenville as a third-party defendant in the New York action (Appendix A, 1a). The Court of Appeals based its opinion on the fact that until the Bank brought suit against A & B, they had no cause of action against Frenville. The court concluded that since claims which arise post-petition are not dischargeable in bankruptcy proceedings, there would be no reason to stay any proceeding predicated on such a claim.

Frenville now petitions this Court for a writ of certiorari. It is clear that the intent of the drafters of the Bankruptcy Code, 11 U.S.C. §§101, *et seq.* were inclined towards a broad interpretation of the §362 automatic stay provisions contained therein, and the procedural history of this action illustrates a "see-saw" swing in the different courts' reading of said language. It is respectfully submitted to this Court that its review of the automatic stay provisions of the Bankruptcy Code, 11 U.S.C. §362, and the applicability of same to the instant action, is warranted.

STATEMENT OF THE BASIS FOR FEDERAL JURISDICTION IN THE COURT OF FIRST INSTANCE

The action which forms the basis for the within petition for a writ of certiorari was commenced by respondent in the United States Bankruptcy Court for the District of New Jersey. Section 1471 of Title 28 of the United States Code confers jurisdiction upon the district courts and its adjuncts, the bankruptcy courts:

> "§1471. Jurisdiction
>
> (a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11. . . .
>
> (c) The bankruptcy court for the district in which a case under title 11 is commenced shall exercise all of the jurisdiction conferred by this section on the district courts. . . ."

28 U.S.C. §§1471(a) and (c). The nature of the action commenced in the Bankruptcy Court was that of automatic stay litigation and, Title 11 being the United States Bankruptcy Code, as such was within the jurisdiction of the Bankruptcy Court.

REASONS FOR GRANTING THE WRIT

The automatic stay provisions of §362 of the Bankruptcy Code are applicable to the matter before this Court.

In its re-drafting of the Bankruptcy Act of 1898, Congress provided safeguards to prevent creditors' attacks on the assets of a debtor estate. Section 362 of the Bankruptcy Reform Act (11 U.S.C. §§101, *et seq.* "The Bankruptcy Code"), provides in pertinent part:

"§362. Automatic Stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3), operates as a stay, applicable to all entities, of--

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the commencement of a case under this title, or to recover a claim against the debtor that arose before the commencement of a case under this title; . . .

(3) any act to obtain possession of property of the estate or of property from the estate; . . .

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; . . . ."

11 U.S.C. §362(a)(1), §362(a)(3), §362(a)(6). In enacting the automatic stay provisions of the Bankruptcy Code, Congress afforded a broad scope of protection to a Title 11 debtor. Said protections include the discontinuance of all collection efforts, all harassment and all foreclosure actions. In addition, the §362 stay protects the creditors of the debtor estate. Without such a stay there would be a "race of diligence" by the creditors for

the assets of the estate, with those who acted first receiving payment of their claims, to the detriment of the other creditors. Legislative History to §362, H. Rep. No. 95-595, 95th Cong. 1st Sess. 340-2 (1977); S. Rep. No. 95-989, 95th Cong. 2d Sess. 49-51 (1978). As is stated therein:

> "The purpose of this provision is to prevent dismemberment of the estate. Liquidation must proceed in an orderly fashion." *Id.*

In *In re Frigitemp Corp.*, 8 BR 284, 289 (S.D.N.Y. 1981), the Bankruptcy Court for the Southern District of New York held that the §362 automatic stay provisions were enacted to prevent a "chaotic and uncontrolled scramble for the debtor's assets in a variety of uncoordinated proceedings in different courts"; *see also, Fidelity Mortgage Investors v. Camelia Builders, Inc.*, 550 F. 2d 47 (2d Cir. 1976), *cert. denied*, 429 U.S. 1093 (1977); *Cornfield v. Investors Overseas, Ltd.*, 471 F. Supp. 1255, 1260 (S.D.N.Y.), *aff'd.*, 614 F. 2d 1286 (1979).

As has been set forth in the Statement of the Case, *supra*, respondent A & B is herein attempting to assess and collect an unliquidated sum from the debtors' estate in an action pending in another forum. There, A & B may find itself liable for the payment of damages resulting from its negligence in the performance of its accounting duties. As of the date of the within petition, no damages have been assessed against respondent, nor will any be assessed until the termination of those proceedings in New York. Not only is respondent attempting to force the debtors into defending an action in a foreign forum, but they are also straining the financial condition of the debtors' estate by necessitating the employment of local, New York counsel to defend such an action. In addition, by forcing the debtors to wait until the New York action is terminated for an assessment of

damages against A & B, respondent is prejudicing the creditors of the debtors' estates in that months, maybe years, will pass before that action is resolved.

The courts below have considered this in their rulings. In the Bankruptcy Court decision, the Hon. D. Joseph De Vito recognized that A & B's suit was not intended to join Frenville as a defendant to the Chase suit, but merely to make the debtors third-party defendants, with Frenville's liability contingent upon that assessed against the third-party plaintiff, A & B, by Chase. In its opinion, the court ruled:

> "In weighing the improbable benefit to the plaintiff against the expense, inconvenience and delay in the administration of the estate, the Court concludes that the debtors have carried their burden of proof in challenging the alleged cause." *In re M. Frenville Co., Inc.,* No. 82-0958 (Bankr. D. N.J. June 22, 1983) (Appendix E, 51a).

On appeal, the United States District Court for the District of New Jersey affirmed the Bankruptcy Court's determination. In an oral opinion, the Hon. Dickinson R. Debevoise held:

> "Plaintiff-appellant seeks relief from the automatic stay provision in order to reach the defendant-debtors' assets. It is precisely the purpose of Section 362 to defeat such an intent on the part of a creditor. Plaintiff's attempts to institute third-party proceedings against defendant-debtors threatens a substantial portion of the estates' assets. Furthermore, the cost of prolonging litigation in a foreign forum is substantially frustrating debtors' attempts to pay creditors under a Chapter VII [sic] plan . . . Therefore, the judgment of the Bankruptcy Court will be affirmed."

See Appendix B, 30a).

In its reversal of the District Court's opinion, the Court of Appeals for the Third Circuit chose to look beyond an interpretation of the language of §362. The court inquired as to when the claim of A & B arose and not when the actual occurrences took place. In determining that A & B's claim arose after the filing of the involuntary Chapter 7 proceedings, the court then looked to New York law to ascertain at what point a third-party complaint for indemnity could be brought. Finding that such an action could not be commenced until the initial action against the defendant had been joined the court reasoned that inasmuch as the suit against A & B was commenced after the filing of the involuntary petitions against the Frenvilles, A & B did not realize they had a claim or a cause of action against the Frenvilles until after said petitions were filed. Further,

> "Although arguably A & B may have had some claim at the time the Frenvilles gave it allegedly false information, it did not have a claim for indemnification or contribution until the banks filed their suit." (*See* Appendix A, 1a).

The Bankruptcy Code, 11 U.S.C. §§101 *et seq.*, provides for the estimation of contingent claims in proceedings thereunder. Section 502(c) of the Bankruptcy Code sets forth:

> "(c) there shall be estimated for the purpose of allowance under this section--
>
> (1) any contingent or unliquidated claim, fixing or liquidation of which, as the case may be, would unduly delay the closing of the case; . . . ."

However, a reading of §502(a) and §502(b) show that, upon objection, the court must determine the allowability of claims and interests presented before it. 3 *Collier on Bankruptcy* (15th ed. 1983) ¶502.05 at p. 502-88, sets forth:

> "Section 502(a), as already seen, gives a claim filed under Section 501 *prima facie* allowability for it is 'deemed allowed' unless objection is taken by a party in interest. Section 502(b), as also seen, describes the kinds of claims that are not allowed to share in the assets of the debtor within the distributive scheme of the Code."

Further, that,

> ". . . if objection is made to a claim, the court, after notice and a hearing, is to determine the amount of the claim as of the date of the filing of the petition commencing the case, and will allow that claim in such amount except to the extent that the claim is unenforceable against the debtor or the debtor's property whether by agreement or applicable law for a reason other than because such claim is contingent or unmatured." 3 *Collier, supra,* ¶502.02 at p. 502-22.

The import of the above subsections to §502 of the Code is that the claim asserted by A & B against the Frenvilles is not merely contingent or unliquidated. At the present time, there is no claim against the debtors herein. There will be none until the termination of the New York state action by Chase against A & B and, if A & B prevails therein, there may not be a cause of action against the debtors. The court must decide, on those facts presented before it, whether or not any action by A & B against Frenville is allowable and whether or not the stay is warranted herein. Claims which

are unenforceable against the debtor or against property of the debtor estate, for reasons other than their being contingent or unliquidated, are simply not allowable for purposes of a right to share in a distribution of the debtor's assets.

Throughout the procedural history of the within action, respondent has relied upon those decisions which do not require investigation into the meaning behind the language contained in §362 of the Bankrupcty Code. Those decisions, *e.g., Weymouth v. York,* 13 BR 757 (Bankr. Me. 1981); *In re Holtkamp Farms, Inc.,* 5 CBC 2d 1412, 1415 (7th Cir. 1982); *In re Terry,* 12 BR 578, 7 BCD 1218 (Bankr. E.D. Wis. 1981), largely deal with instances wherein the actual occurrence took place after the commencement of the bankruptcy proceedings. In the *Holtkamp* decision, the Court of Appeals for the Seventh Circuit was faced with a situation wherein to permit continuation of litigation against a debtor would seriously have jeopardized the administration of the estate, as well as reduce the actual amount of the estate available for distribution to creditors. In *Holtkamp,* however, the debtor's insurance company came forward and indicated to the court that it would assume the financial responsiblity for said litigation, together with the payment of any judgment that might arise thereunder. Given these assurances, then, the court permitted the litigation to continue. The appeals court ruled:

> ". . . the statute [11 U.S.C. §362] commits the decision of whether to lift the stay to the discretion of the bankruptcy judge [and] his decision may be overturned only upon a showing of abuse of discretion."

5 CBC 2d at 1415.

The Bankruptcy Court herein, as well as the District Court in its affirmance, has not abused its discretion in applying the

§362 automatic stay provisions to this matter. Both courts have carefully reviewed the merits of the actions, both before the Bankruptcy Court and before the New York court, and both have determined that there would be an unreasonable burden placed upon the debtor estates should the stay be lifted, and the third-party complaint permitted. Inasmuch as the proceedings under Chapter 7 are pending before the court of first instance, and that court is totally familiar with all of the aspects of such proceedings, it was well within its discretion in applying said automatic stay provisions herein.

CONCLUSION

For all of the foregoing reasons, case law and statutory authority, it is respectfully submitted to this Court that both the United States Bankruptcy Court and the United States District Court in its affirmance, were well within their respective discretions in continuing the provisions of the Section 362 automatic stay as said stay applies to the action now brought before this Court. This Court is respectfully urged to grant certiorari herein to permit it to review the decision of the United States Court of Appeals which reversed and remanded the lower court's findings.

Respectfully submitted,

MYRON S. LEHMAN
LEHMAN & WASSERMAN, P.C.
Attorneys for Petitioner

APPENDIX A — DECISION OF UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT FILED SEPTEMBER 17, 1984**

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 83-5789

In the Matter of:
M. FRENVILLE CO., INC., RUDOLPH F. FRENVILLE, JR. and RUDOLPH F. FRENVILLE, SR.

AVELLINO & BIENES, A Partnership

Appellant

v.

M. FRENVILLE CO., INC. and RUDOLPH F. FRENVILLE, SR., and CHARLES STANZIALE, ESQ., Interim Trustee

---

On Appeal from the United States
District Court for the
District of New Jersey
(C. A. No. 83-2810)

Argued June 15, 1984

Before: SEITZ, *Chief Judge*,
STEWART, *Associate Justice (Retired)**
and ADAMS, *Circuit Judge*

(Filed September 17, 1984)

McDonough, Murray & Korn
Westfield, New Jersey 07091
On the Brief:
JAY SCOTT MacNEILL (Argued)
Attorneys for Appellant

---

* Justice Potter Stewart, Associate Justice (retired) of the United States Supreme Court sitting by designation.

** As of the date of the petition for writ of certiorari, your petitioner has not yet received a copy of the judgment entered herein.

Appendix A

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Attorneys for M. Frenville Co., Inc. and Rudolph F. Frenville, Sr.

BEN H. BECKER,
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East Orange, New Jersey 07091

Attorneys for Interim Trustee

OPINION OF THE COURT

ADAMS, *Circuit Judge*

This is an appeal by Avellino & Bienes (A&B) from a ruling by the district court, affirming the judgment of the bankruptcy court, that A&B's action against M. Frenville Co., Inc. and Rudolf Frenville, Sr. was barred by the automatic stay provision of the Bankruptcy Reform Act of 1978 (the Code), 11 U.S.C. § 362(a)(1) (1982). The critical issue is whether the automatic stay provision applies to cases in which the acts of the debtor occurred before the filing of the bankruptcy petition yet the cause of action stemming from those acts arose post-petition. For the reasons set forth, we reverse the district court's judgment.

I.

The facts of this case are undisputed. A&B is a certified public acounting firm located in New York City. From 1977 to 1979 A&B was engaged by M. Frenville Co., Inc. as an independent auditor and

accountant. As part of its duties, A&B prepared certified financial statements of the company for fiscal years 1978 and 1979.

In July 1980, creditors of Frenville filed an involuntary petition for bankruptcy against the company under chapter 7 of the Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 701 *et seq.* (1982). In January, 1981, creditors also filed involuntary petitions under chapter 7 of the Code against two principals of the company: Rudolph Frenville, Sr. and Rudolph Frenville, Jr.[1]

The Chase Manhattan Bank, N.A., the Fidelity Bank, Fidelity International Bank and Girard International Bank (the banks) filed suit in the Supreme Court of New York on November 16, 1981 against A&B. The complaint alleged that A&B negligently and recklessly prepared the Frenville financial statements, that the statements were false, and that because of their reliance on the statements, the banks had collectively suffered losses in excess of five million dollars.

As a result of the suit by the banks, A&B filed a complaint on January 10, 1983, in the Bankruptcy Court for the District of New Jersey, which was administering the Frenvilles' chapter 7 proceedings. In the bankruptcy court, A&B sought relief from the automatic stay provision of § 362(a) in order to include the Frenvilles as third-party defendants in the New York state proceeding. The purpose of the third-party complaint was to obtain indemnification or contribution from the Frenvilles for any loss suffered by A&B as a result of the suit by the banks.

---

1. M. Frenville Co., Inc. will be referred to as "Frenville." M. Frenville Co., Inc. and Rudolph Frenville, Sr. collectively will be referred to as the "Frenvilles." Rudolph Frenville, Jr., although involved in the bankruptcy proceedings, is not a party to A&B's proposed action.

Appendix A

The bankruptcy judge held the automatic stay provision of § 362(a) was applicable to A&B's suit because the Frenvilles' liability, if any, resulted from their pre-petition acts. Moreover, the bankruptcy judge refused to grant relief from the automatic stay as provided in § 362(d) of the Code.[2] The district court affirmed the bankruptcy judge's order that the automatic stay barred A&B's action for indemnification or contribution.

II.

We must decide today whether the automatic stay of § 362(a) of the Code is applicable when the debtor's acts which form the basis of a suit occurred pre-petition but the actual cause of action which is being instituted did not arise until after the filing of a bankruptcy petition. The automatic stay provision provides that

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title ... operates as a stay, applicable to all entities, of--
>
> > (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or *could have been commenced before* the commencement of the case under this title, or to recover a claim against the debtor that *arose before* the commencement of the case under this title;

11 U.S.C. § 362(a)(1) (emphasis added).

---

2. Since we hold that the automatic stay, by its own terms, is inapplicable in the present case, we need not reach the issue of whether relief from the stay was warranted.

Appendix A

The automatic stay provision of § 362(a) is one of the fundamental protections provided to a debtor by the Code. Congress' intent in enacting § 362(a) is clear -- it wanted to stop collection efforts for all antecedent debts. Congress intended that the debtor obtain a fresh start, free from the immediate financial pressures that caused the debtor to go into bankruptcy. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 340-42 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 49-51 (1978); *see also Turner Broadcasting System, Inc. v. Sanyo Electric Inc.*, 33 B.R. 996, 999-1000 (N.D. Ga. 1983); 1 W. Norton, Jr., *Norton Bankruptcy Law and Practice* § 20.04 (1981).

Yet despite the broad reach of the automatic stay, it is not all encompassing. Section 362(b), for example, provides exemptions from the automatic stay.[3] As a

---

3. In addition to the restriction of § 362(a)(1), the Code states that:

> (b) The filing of a petition under section 301, 302, or 303 of this title ... does not operate as a stay--
>
> (1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;
>
> (2) under subsection (a) of this section, of the collection of alimony, maintenance, or support from property that is not property of the estate;
>
> (3) under subsection (a) of this section, of any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title;
>
> (4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;
>
> (5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a

further restriction, the Code requires that the proceeding stayed "was or could have been commenced" before filing or that the proceeding was based on a claim that arose pre-petition. § 362(a)(1); *see In re York*, 13 B.R. 757, 758 (Bankr. D. Me. 1981). Proceedings or claims arising post-petition are not subject to the automatic stay. *See, e.g., Turner Broadcasting System, Inc. v. Sanyo Electric, Inc.*, 33 B.R. 996, 999-1000 (N.D. Ga. 1983); *In re Powell*, 27 B.R. 146, 147 (Bankr. W.D. Mo. 1983); *In re Anderson*, 23 B.R. 174, 175 (Bankr. N.D. Ill. 1982); *In re York*, 13 B.R. 757, 758-59 (Bankr. D. Me. 1981). In *Anderson*, for example, the debtor signed a contract for shipping services with several shipping companies on August 1, 1981. On November 12, 1981, the debtor filed a petition for relief under chapter 13 of the Code. Three months after the petition was filed the shipping companies commenced suit, alleging that the debtor had submitted fraudulent shipping charges. The court held that the automatic stay did not apply. Although the parties had signed the contract pre-petition, the

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governmental unit to enforce such governmental unit's police or regulatory power;

(6) under subsection (a) of this section, of the setoff by a commodity broker, forward contract merchant, stockbroker, or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts....

(7) under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by said Secretary is insured or was formerly insured under the National Housing Act....; or

(8) under subsection (a) of this section, of the issuance to the debtor by a governmental unit of a notice of tax deficiency.

alleged fraud did not begin until December 24, 1981, a month after the petition was filed. Since the shipping companies' claim arose post-petition, the bankruptcy court declared that § 362(a) was inapplicable.

Only proceedings that could have been commenced or claims that arose before the filing of the bankruptcy petitions are automatically stayed. It is undisputed that the Frenvilles' acts which ultimately led to A&B's suit for indemnification or contribution occurred in 1978 or 1979, well before the chapter 7 petitions were filed. Section 362(a)(1), however, refers to "proceedings" and "claims" against, not acts done by, the debtor. Pre-petition acts by a debtor, by themselves, are not sufficient to cause the automatic stay to apply. In most cases, the claim or cause of action will arise simultaneously with the underlying act. But to the extent that the harm is separated from the underlying conduct, at least for purposes of § 362(a), Congress has focused on the harm, rather than the act. *Cf. Anderson*, 23 B.R. at 175 ("The fact that a contract was executed among the parties [pre-petition] is not sufficient basis to hold that the claim arose prior to filing."); *In re THC Financial Corp.*, 686 F.2d 799, 804 (9th Cir. 1982) (although express indemnity agreement arose pre-petition, the related unjust enrichment claim arose post-petition). Thus, unless A&B could have proceeded with its suit before the bankruptcy petitions were filed in July, 1980,[4] or had a claim against the Frenvilles which arose before that date, the automatic stay is inapplicable.

The proceeding which A&B sought to institute was an action for indemnity or contribution in New York

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4. For convenience, we will refer to the earlier July 1980 petition against Frenville as the filing date for both petitions; nothing of consequence occurred between July 1980 and January 1981.

state court. According to New York law, a third-party complaint for contribution or indemnity may be commenced at the time the defendant (in the present case A&B) serves his answer in the suit brought by the plaintiff (here, the banks), but not before. N.Y. Civ. Prac. Law § 1007 (McKinney 1976);[5] *see also Blum v. Good Humor Corp.*, 57 A.D.2d 911, 394 N.Y.S.2d 894 (N.Y. App. Div. 1977); *Taca International Airlines, S.A. v. Rolls Royce of England, Ltd.*, 47 Misc.2d 771, 263 N.Y.S.2d 269, 272 (N.Y. Sup. Ct. 1965) (indemnification suit "could not be commenced by defendants until after service of their answer"); *Musco v. Conte*, 22 A.D.2d 121, 254 N.Y.S.2d 589, 595 (N.Y. App. Div. 1964). In the present situation, A&B could not bring a proceeding for indemnification or contribution until it filed its answer in the suit instituted by the banks on November 16, 1981, some fourteen months after the filing of the bankruptcy petitions. Consequently, A&B's suit cannot be stayed by the "proceeding" language of § 362(a)(1).

The applicability of the automatic stay, therefore, depends on whether A&B's claim arose pre-petition. The Code defines a "claim" as a

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, dispute, undisputed, legal, equitable, secured, or unsecured; or
>
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to

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5. N.Y. Civ. Prac. Law § 1007 states (in pertinent part):

> After the service of his answer, a defendant may proceed against a person not a party who is or may be liable to him for all or part of the plaintiff's claim against him, by serving upon such person a summons and third-party complaint and all prior pleadings served in the action.

> payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured;

11 U.S.C. § 101(4) (1982).

Congress intended the definition of a claim to be very broad; the legislative history states:

> The definition is any right to payment, whether or not reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured. ... By this broadest possible definition and by the use of the term throughout the title 11, especially in subchapter I of chapter 5, the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court.[6]

At first glance, A&B might be thought to have had an unliquidated, contingent, unmatured and disputed claim pre-petition. While all of these adjectives may describe A&B's cause of action against the Frenvilles, the threshold requirement of a claim must first be met -- there must be a "right to payment." § 101(4)(A). One court noted that "although the code definition of claim has been drafted in extremely broad terms, such definition may not confer the status of a claimant upon a petitioning creditor who has no right to payment." *In re First Energy Leasing Corp.*, 38 B.R. 577, 581

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6. H.R. Rep. No. 595, 95th Cong., 2d Sess. 309, *reprinted in* 1978 U. S. Code Cong. & Ad. News 5963, 6266; *see also* S. Rep. No. 989, 95th Cong., 2d Sess. 21-22, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5785, 5807-08 (virtually identical statement).

(Bankr. E.D.N.Y. 1984); *see also In re McMeekin*, 16 B.R. 805, 808 (Bankr. D. Mass. 1982).

Thus we must determine at what point A&B had a "right to payment" for its claim for indemnification or contribution. Of course, if A&B is found liable to the banks, it would have a right to payment from the Frenvilles (assuming liability for the moment), albeit a disputed and unliquidated one. The crucial issue, however, is when did A&B's right to payment arise, for the automatic stay provision applies only to claims that arise pre-petition. *See In re Thomas*, 12 B.R. 432, 433 (Bankr. S.D. Iowa 1981) ("The existence of a 'claim' turns on when it arose.").

The present case is different from one involving an indemnity or surety contract. When parties agree in advance that one party will indemnify the other party in the event of a certain occurrence, there exists a right to payment, albeit contingent,[7] upon the signing of the agreement. *See In re THC Financial Corp.*, 686 F.2d 799, 802-04 (9th Cir. 1982); *In re All Media Properties, Inc.*, 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff'd*, 646 F.2d 193 (5th Cir. (Unit A) 1981) (per curiam). Such a surety relationship is the classic case of a contingent right to payment under the Code -- the right to payment exists as of the signing of the agreement, but it is dependent on the occurrence of a future event. *See All Media*, 5 B.R. at 133. A&B, however, had no

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7. Bankruptcy judges have defined a contingent claim as a claim which becomes due only on the occurrence of a future event. *See, e.g.*, In re Dill, 30 B.R. 546, 549 (Bankr. 9th Cir. 1983). One frequently cited definition of contingent is that "claims are contingent as to liability if the debt is one which the debtor will be called upon to pay only upon the occurrence or happening of an extrinsic event." In re All Media Properties, Inc., 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff'd*, 646 F.2d 193 (5th Cir. (Unit A) 1981) (per curiam).

indemnity agreement with the Frenvilles. Accordingly, cases holding that a claim arises upon the signing of an indemnity agreement are inapposite.

We must ascertain when a right to payment for an indemnity or contribution claim arises where there is no specific agreement. Although "claim" is defined by § 101(4), the Code does not define when a right to payment arises. Thus, while federal law controls which claims are cognizable under the Code, the threshold question of when a right to payment arises, absent overriding federal law, "is to be determined by reference to state law." *Vanstun Bondholders Protective Commitee v. Green*, 329 U.S. 156, 161 (1946); *see also In re McMeekin*, 16 B.R. 805, 808 (Bankr. D. Mass. 1982); *In re Thomas*, 12 B.R. 432, 433 (Bankr. S.D. Iowa 1981).[8]

We look to New York law to ascertain at what point A&B's claim arose. For both separate actions and third-party complaints, a claim for contribution or indemnification does not accrue at the time of the commission of the underlying act, but rather at the time of the payment of the judgment flowing from the act. *See Blum v. Good Humor Corp.*, 57 A.D.2d 911, 394 N.Y.S.2d 894, 896 (N.Y. App. Div. 1977); *Taca International Airlines, S.A. v. Rolls Royce of England, Ltd.*, 47 Misc.2d 771, 263 N.Y.S.2d 269, 272 (N.Y. Sup. Ct. 1965). Although such a claim does not mature until payment is made, the New York Civil Practice Code permits a defendant to institute a third-party claim

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8. If there were some overriding federal policy, we might have the power to develop federal law. *See* In re Beck Indus., Inc., 725 F.2d 880, 891 (2d Cir. 1984); In re Johns-Manville Corp., 36 B.R. 743, 751 n.4 (Bankr. S.D.N.Y.), *appeal denied*, 39 B.R. 234 (S.D.N.Y. 1984). A bankruptcy proceeding stemming from a mass tort -- such as exposure to asbestos -- may be a case in which the application of federal law is indicated.

against a party who may be liable to him for all or part of the plaintiff's claim after service of his answer. N.Y. Civ. Prac. Law § 1007 (McKinney 1976). In circumstances similar to the present case, one court stated:

> Technically a claim for indemnity does not arise until the prime obligation to pay has been established.... Nevertheless, for the sake of fairness and judicial economy, [N.Y. Civ. Prac. Law § 1007] allows third-party actions to be commenced in certain circumstances before they are technically ripe, so that all parties may establish their rights and liabilities in one action. ... Moreover, there is no justification for permitting a claim of indemnity where the primary action which might be the source of the right to indemnity ... is not even pending.

Burgundy Basin Inn v. Watkins Glen Grand Prix Corp., 51 A.D.2d 140, 379 N.Y.S.2d 873, 880 (1976 N.Y. App. Div.) (citations omitted).

In the case at bar, A&B had an unmatured, unliquidated, disputed claim when the banks brought suit against it in New York state court. Until the banks instituted suit, however, A&B did not have any claim or cause of action based on indemnity or contribution against the Frenvilles. Since the banks' suit began some fourteen months after the filing of the Frenvilles' involuntary chapter 7 proceedings, A&B's claim, as well as its cause of action, arose post-petition. Although arguably A&B may have had some claim at the time the Frenvilles gave it allegedly false information, it did not have a claim for indemnification or contribution until the banks filed their suit. Thus, by its very terms, the automatic stay provision of § 362(a) is inapplicable to A&B's suit.

Appendix A

III.

Our decision today is in keeping with the policy of the Code. Congress has determined that only those claims which arise pre-petition[9] can be discharged in a chapter 7 proceeding.[10] Since claims arising post-petition are not dischargeable, there is no compelling reason to stay judicial proceedings predicated on such claims. *See Turner Broadcasting*, 33 B.R. at 1000; *In re Shenberg*, 433 F.Supp. 677, 680 (N.D. Ill. 1977); Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. Mich. J.L. Ref. 177 (1978).

IV.

We conclude that the automatic stay does not apply to A&B's proposed action against the Frenvilles.[11]

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9. Technically, the date crucial for discharge (as opposed to the automatic stay) is the date of the bankruptcy court's order for relief. In the present case, the bankruptcy judge entered orders for relief within a month of the filing of the petitions.

10. 11 U.S.C. § 727(b) (1982) provides that:

> Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter, and any liability on a claim that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title, and whether or not a claim based on any such debt or liability is allowed under section 502 of this title.

Other discharge provisions in the Code are 11 U.S.C. §§ 944, 1141, 1328, 15727 (1982).

11. Should A&B succeed in obtaining a judgment against the Frenvilles in the New York proceeding, the provisions of § 362(a)(3) and (4) would be applicable. *See Turner Broadcasting System, Inc. v. Sanyo Electric, Inc.*, 33 B.R.

Appendix A

Therefore, the district court's judgment will be reversed and the matter remanded for proceedings consistent with this opinion.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit

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996, 1000 n.2 (N.D. Ga. 1983); *In re Powell*, 27 B.R. 146, 147 (Bankr. W.D. Mo. 1983); *In re Anderson*, 23 B.R. 174, 175 (Bankr. N.D. Ill. 1982); *In re York*, 13 B.R. 757, 758-59 (Bankr. D. Me. 1981).

11 U.S.C. § 362(a)(3) and (4) (1982) provide:

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title ... operates as a stay, applicable to all entities, of --
>
> . . .
>
> (3) any act to obtain possession of property of the estate or of property from the estate;
>
> (4) any act to create, perfect, or enforce any lien against property of the estate;

Thus, A&B will have to seek relief from the automatic stay to collect any judgment it might obtain.

APPENDIX B — TRANSCRIPT OF ORAL DECISION OF THE HON. DICKINSON R. DEBEVOISE, U.S.D.J. DATED SEPTEMBER 26, 1983

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Civil No. 83-2810

AVELLINO & BIENES,

Plaintiff,

v.

M. FRENVILLE CO., et al.,

Defendant.

Newark, New Jersey

September 26, 1983

BEFORE:

HONORABLE DICKINSON R. DEBEVOISE
UNITED STATES DISTRICT JUDGE

Appearances:

MC DONOUGH, MURRAY & KORN, ESQS.
BY: SUSAN MORYAN, ESQ.,
For the Appellant

LEHMAN & WASSERMAN, ESQS.,
BY: STEVEN JURISTA, ESQ.,
For the Appellees

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BEN H. BECKER, ESQ.,
For the Trustee

[2] THE COURT: Avellino against Frenville.

THE COURT: Miss Moryan, are you for the appellant?

MS. MORYAN: Yes.

THE COURT: What do you want to add to your briefs?

MS. MORYAN: This is our appeal from the order of the Bankruptcy Court holding the automatic stay provision of Section 362 does apply in this case, and also failing to grant us relief from that stay.

THE COURT: Yes.

MS. MORYAN: On appeal we are just challenging that order on the grounds that the automatic stay provision of Section 352 does not apply in this case because this action we seek to bring in the Frenville, the third-party action in a case that has been instituted in New York against Avellino and Bienes, brought by several banks.

That action, or our third-party action could not have been commenced before the bankruptcy case in this matter. The complaint filed by the Bank in New York was filed in November of 1981, ten months after the last involuntary petition was filed.

Prior to that time there was absolutely no reason to suspect that a lawsuit would be brought, that there was any cause of action whatsoever against Frenville.

[3] We seek to bring in Frenville as third-party defendant seeking contribution and indemnification. That cause of action does not arise until the parties seeking indemnification makes payment, although to one multiplicity of suits --

THE COURT: Can you file a proof of claim in the bankruptcy proceedings for indemnification?

MS. MORYAN: Yes, we did. We filed a complaint.

THE COURT: All right. But in the bankruptcy proceeding itself, you can proceed against Frenville.

MS. MORYAN: Yes. Well, he —

THE COURT: That's really a question I don't know the answer to. You started — you want to start an independent action, or you want to file a cross-claim in the New York proceedings?

MS. MORYAN: We want to file a third-party complaint because Frenville is not defendant in the other proceeding.

THE COURT: Yes, you're right. So my question is, really, could you file a similar proceeding against Frenville in the bankruptcy proceeding?

MS. MORYAN: I don't think we can. But I'm not really sure of the answer to that question.

THE COURT: Maybe you would know, representing the trustee.

[4] MR. JURISTA: They can't, your Honor.

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THE COURT: Cannot. So in other words, they are out.

MR. JURISTA: They are out.

THE COURT: They can either file a proof of claim or an action against them.

MR. JURISTA: That's correct. If there is any action that they can file, it would only be in the Bankruptcy Court, the Bankruptcy Court being the only court having jurisdiction over any other financial matters involving the debtor's defendant Frenville.

THE COURT: You say they cannot file an action in the Bankruptcy Court?

MR. JURISTA: Not for indemnity.

THE COURT: Well, they will be owed — presumably they will owe money if they lose that case to the banks. Also, if there were no bankruptcies, they would undoubtedly be able to collect that from the debtor here.

MR. JURISTA: They can file a claim in the bankruptcy proceedings.

THE COURT: That's what I'm asking.

MR. JURISTA: They can file a claim.

THE COURT: Then they would get their pro rata share of the assets along with all the other general creditors.

[5] Why isn't that the way you should proceed?

Appendix B

MS. MORYAN: I think because, your Honor, the case in New York is just pending and the bankruptcy petitions will probably be resolved way before the New York action is resolved.

THE COURT: Maybe they will have to keep a reserve or something. I don't know how the Bankruptcy Courts handle that. But suppose you get a judgment against Frenville in the New York action? You would be seeking to recover the entire amount, I suppose. And you would be hoping that's not discharged in bankruptcy.

MS. MORYAN: That's what we would be hoping. But the point is, I mean, whether or not we would be able to recover the entire amount, I think the trustee makes the point — well, that misses the point, not whether we are entitled to relieve, but whether the automatic stay provision applies at all here. We are arguing that it doesn't.

We have a right to have the whole matter before the New York court. There are allegations of fraud involved in this case, and I think that that trier of fact has a right to get all the facts before it, including possible wrongdoing by the debtors.

THE COURT: Isn't this going to be an issue in your defense of the action by the banks against you, that we were perfectly blameless because we were defrauded by [6] Frenville?

MS. MORYAN: That's right. And the whole point of this appeal is that we could not have known that. We could not possibly have started the third-party action against the Frenvilles before we were sued by the banks. Not only that, we didn't know beforehand that there was any — we were provided possibly with some information by the Frenvilles, and even if we did know,

which we didn't, we had not suffered any damage up to that point. There was no cause of action.

Nothing had occurred before the complaint was filed by the banks in November of 1981, after the involuntary bankruptcy petitions were filed, to suggest at all that we might have to answer to someone else for fraud perpetrated on us by the Frenvilles.

The language of Section 362 is clear, although the financial statements were prepared pre-bankruptcy petition, I don't think that is really — has anything to do with what the language of the statute says.

The statute says, "could have been commenced or arose before," and clearly this cause of action did not arise before the bankruptcy petitions were filed.

THE COURT: Who will be arguing? Mr. Jurista?

MR. JURISTA: Yes, your Honor please.

With all due respect to my adversary, I do not agree with her interpretation of the statute. The statute is [7] clear in that it automatically stays any action initiated or could have been commenced prior to the bankruptcy proceeding.

THE COURT: This couldn't have been commenced.

MR. JURISTA: The cause of action arose prior to the bankruptcy proceeding.

THE COURT: It is giving it a very unusual definition of cause of action, an arising. Usually it arises when the last event

takes place which permits you to go into court and sue on. So it was, what would we call it, a possible cause of action, but there is no cause of action against the accountants until the banks sue the accountants and recover from the accountant. Then the cause of action arises.

MR. JURISTA: Well, yes and no. The cause of action dates back to the time that these financial statements were prepared. That's the basis of the cause of action by the banks against the accountants.

That particular bank —

THE COURT: There might have been no injury. There is no cause of action until this damage. It hasn't arisen there. That's a potential, possible cause of action which might arise. The kind of thing where you notify your insurance carrier, something might come up later. But it's no cause of action.

MR. JURISTA: Notwithstanding that, if I may [8] defer on that for a moment, the fundamental basis of any bankruptcy proceeding is to consolidate the debtor's financial affairs, give them either a discharge or reorganize his financial affairs, depending on what chapter of the Bankruptcy Code the case was filed under.

If the debtor was forced to litigate cases in various jurisdictions over all the country based upon indemnification or whatever, that whole concept which is fundamental to the Bankruptcy Code, would be rendered meaningless.

THE COURT: Suppose he has a series of automobile accidents after he files his petition? He hits one person in one

state, hits another person in another state. Can he be required to defend all those actions?

MR. JURISTA: Yes, post petition, your Honor. That's what the York case says that plaintiff cited.

THE COURT: What they are saying is this is really post petition too, because the -- what stimulates or what creates the cause of action is the suit by the banks and recovery by the banks against the accountants. Then the cause of action begins.

MR. JURISTA: I still think the cause of action arose at the time the financial statements were prepared.

THE COURT: If it is, then it is a different meaning that is being given in Section 362 of the Bankruptcy [9] Code from the usual meaning, the arising of a cause of action, and maybe you are arguing that there is a special meaning under 362 because of the purposes which you're alluding to.

MR. JURISTA: That's correct. Notwithstanding that, the plaintiff still has a means of defending. There is nothing prohibiting them from subpoening the Frenvilles to testifiy in that proceeding. They do not necessarily have to be made a third-party defendant.

THE COURT: They just want money from Frenville.

MR. JURISTA: Of course.

THE COURT: How can they get their money if they don't sue them there, or even get their proportionate share of the assets?

Appendix B

MR. JURISTA: They can file a proof of claim in the bankruptcy proceeding.

THE COURT: If they do that, the amount won't be known until the end of the proceedings against them in New York, which may be nothing, it may be millions of dollars. So what does the Bankruptcy Court do then with this claim in an indefinite amount?

MR. JURISTA: The Bankruptcy Court has a procedure for estimating contingent claims. Part of the problem which arose under the old Bankruptcy Act prior to 1979 was for these contingent claims, which had a difficult time being estimated. The Bankruptcy Courts did allow other courts [10] to continue litigation in order to fix the amount of that claim.

There is a procedure under Section 502 of the Bankruptcy Code to enable a Bankruptcy Court to estimate that claim for purposes of filing a claim.

So I don't think that's difficult in this particular matter, your Honor.

THE COURT: All right. Thank you. Anything else?

MR. BECKER: Your Honor, in behalf of the trustee, I would like to emphasize a point that the estate, really, in terms of the -- in relationship to the significance of the claim against Avellino and Bienes, is going to be virtually exhausted by administration, particularly when we are talking about M. Frenville Co, Inc. We have an estate that's approximately $50,000 at this point. We have claims against Avellino and Bienes by the banks, if they are successful, and I believe far in excess of five million dollars.

Really, in terms of the corporation, even if they were to file a proof of claim in the Bankruptcy Court, Avellino and Bienes, and obtain a distribution, that distribution would only on a prorated basis diminish the distribution received by the banks.

I assume the only claim -- as your Honor [11] correctly pointed out, there would be no claim by Avellino and Bienes against the Frenvilles if there were no damages suffered by the banks. To the extent that Avellino and Bienes is able to file a proof of claim in the Bankruptcy Court and receive proceeds, it only diminishes the sum the banks will themselves get out of the proceeds.

As a practical matter, I don't really think they gain anything by bringing the trustee and the estate into the proceedings.

THE COURT: That's why they want to sue outside the estate.

Suppose they sue outside the estate. They get a judgment against Frenville Companies, and I suppose they are suing the individuals. Are they in bankruptcy too?

MS. MORYAN: Yes.

THE COURT: I suppose they are going to argue that it is something that's not dischargeable in bankruptcy. Can they argue that anyway?

MR. BECKER: They can argue that in the Bankruptcy Court. They would have to file a complaint objecting to the dischargeability of the debts from the Frenvilles, and they probably would have to seek leave of Court to extend the time for filing that objection. But that's something that is peculiarly a Bankruptcy Court action.

Appendix B

MS. MORYAN: Just a brief response.

[12] The question of whether or not we can file in the Bankruptcy Court really does not meet the point here.

There arguments as to you are to get a fresh state only implies that we are seeking relief, not whether we are challenging whether it applies or not. It will be easier for a court in the New York action to decide what the claims against the Frenvilles are worth rather than having a bankruptcy judge estimate them, which is the Bankruptcy Court procedure.

THE COURT: I was inquiring into those areas insofar as it might throw light on the meaning of the statute. Let me put a brief opinion on the record.

Plaintiff-appellant appeals from an opinion and order of the United States Bankruptcy Court for the District of New Jersey dated June 22, 1983, denying plaintiff's request for relief from the automatic stay provisions of Section 362 of the Bankruptcy Code. Plaintiff-appellant seeks this relief in order to permit the inclusion of defendants-appellees M. Frenville Co., Inc. and Rudolph F. Frenville, Sr. as third-party defendants in an action pending in the Supreme Court of the state of New York. For the reasons discussed below, the order of the Bankruptcy Court will be affirmed.

Plaintiff-appellant Avellino and Bienes is a certified public accounting firm located in New York City. For the years ending August 31, 1978 and August 31, 1979, [13] Avellino and Bienes, which I will refer to as A&B, prepared audited financial statements for M. Frenville Co., Inc.

Appendix B

An involuntary petition under Chapter VII of the Bankruptcy Code was filed against M. Frenville Co., Inc. on July 8, 1980 and an order for relief was subsequently entered. Thereafter, on January 21, 1981, involuntary petitions were filed under Chapter VII against the two principals of the company, Rudolph Frenville, Sr. and Rudolph Frenville, Jr. Orders for relief were entered on February 20, 1981.

On November 16th, 1981, Chase Manhattan Bank, N.A., Fidelity Bank, Fidelity International Bank and Girard International Bank insituted a suit in the Supreme Court of New York against A&B alleging negligence and recklessness in the performance of its accounting duties with regard to the financial statements it prepared for the years 1978 and 1979. These banks claim the financial statements were false and that as a result of their reliance on them, the banks suffered a loss of funds in excess of five million dollars.

A&B filed a complaint in the United States Bankruptcy Court for the District of New Jersey on January 10, 1983. In that complaint A&B sought relief from the automatic stay imposed pursuant to Section 362 of the Bankruptcy Code in order to institute a third-party action against the corporate debtor and the individual debtors in the lawsuit pending in the Supreme Court of New York. The purpose of the third-party [14] complaint would be to obtain contribution and indemnification from the defendant-debtors on grounds that they allegedly supplied false information to A&B for use in the preparation of the financial statement.

The Bankruptcy Court held a hearing on this matter on February 8, 1983 and issued an opinion and order denying plaintiff relief on June 22. In its opinion, the Bankruptcy Court found the automatic stay provisions of Section 362 are applicable to

A&B's claim since this claim is based upon acts which occurred prior to the filing of the involuntary petition.

A&B filed a notice of appeal on July 1st and now seeks reversal of the Bankruptcy Court's order on the ground that the Bankruptcy Court erred in holding that the automatic stay provision of Section 362 applies to the instant action.

Resolution of the issue presented by A&B's appeal from the Bankruptcy Courts decision turns on the proper interpretation of the automatic stay provision. This provision provides in pertinent part:

"(a) Except as provided in subsection (b) of this section, a petition filed under Section 301, 302 or 303 of this title operates as a stay applicable to all entities of (i) the commencement or continuation, including the issuance or employment of process of a judicial, administrative or other proceeding against the debtor that was or could have [15] been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title." 11 U.S.C. Section 362(a)(1).

A&B argues that Section 362 is not applicable to the instant facts inasmuch as A&B had no cause of action against defendant-debtors for contribution and indemnification until the banks instituted suit against A&B ten months after that bankruptcy petition was filed. Therefore, A&B asserts a suit against defendant could not have been commenced nor arose before the commencement of the bankruptcy case.

In support of their contention, A&B relied upon *Weymouth v. York*, 13 Bankruptcy Reports 757 (B. Ct. Me. 1981). That case

involved a debtor who was involved in an automobile accident approximately six months after the filing of the bankruptcy petition. The Court vacated the automatic stay to permit the plaintiff injured in the accident to proceed with a personal injury suit against the debtor. In contrast to the case at bar where the facts underlying A&B's cause of action occurred prior to the filing of the petition, the facts forming the basis for the personal injury suit in *Weymouth* occurred subsequent to the filing of the debtor's petition. A&B's argument that the banks' institution of the suit against A&B is the only fact relevant to determination of when their cause of action arose must be rejected. Both the suit brought [16] by the banks against A&B and A&B's attempted third-party action against defendants stem from the activities of the parties during the years 1978 and 1979 prior to the filing of the bankruptcy petitions. In these circumstances, granting plaintiff-appellant A&B's relief would be contrary to the purposes of Section 362. The Court in the *Matter f Briarcliff*, 15 Bankruptcy Reports 864, 865 (D.N.J. 1981) noted:

"The outflow of assets from a bankrupt's estate is stopped by the stay under Section 11 by restraining suits against a bankrupt which litigate claims which are dischargeable in bankruptcy and which arise from prefiling activity."

Courts confronted with similar facts to those present in the instant case have declined to grant plaintiff's seeking subrogation rights against bankrupts relief from the automatic stay provision of the Bankruptcy Code. In *Elliott v. Hardison,* 25 Bankruptcy Reports 305 (E.D. Va. 1982), the bankrupt was involved in a vehicular accident approximately seven months before he filed a voluntary petition in bankruptcy. After the petition was filed, a personal injury suit was filed against the bankrupt by a party injured in the accident. The Court permitted this personal injury

suit to proceed in order for the injured party to establish the legal liability of the bankrupt, a prerequisite to recovering under [17] an uninsured motorist policy. The insurance company then sought to use the subrogation rights against the uninsured bankrupt, however, the Court held that Section 362 precluded such an action since it would substantially jeopardize the bankrupt's fresh start in contravention of the policy of the Bankruptcy Code.

The purposes of Secion 362 of the Bankruptcy Code are clearly articulated in the legislative history set forth in 1978 U.S. Code and Congressional and Administrative News at pages 6296-97, which I will not read here, and to which reference is made.

The automatic stay served to preserve what remained as a debtor's solvent state and to provide equitable liquidation procedures to both secured and unsecured creditors, thereby preventing a chaotic and uncontrollable scramble for the debtor's assets in a variety of uncoordinated proceedings in different courts. *Fidelity Mortgage Investors v. Camielia Builders, Inc.*, 550 F. 2d 47 (2d Cir. 1976), *cert. denied* 429 U.S. 1093 (1977). *Cornfield v. Investors Overseas Services, Ltd.*, 471 F. Supp. 1255 to 1260 (S.D. N.Y.), *affirmed* 614 F. 2d 1286 (1979). Congress recognized, however, that in some context, permitting a civil suit to proceed against a debtor would not subvert the purposes of Section 362. Thus, the courts are permitted to grant relief from the automatic stay when no interference with the pending [18] bankruptcy case would result and where such relief would allow an action to proceed to completion in another tribunal without damaging the bankrupt estate. 11 U.S.C. Section 362(d); 1978, U.S. Code Congressional and Administrative News at 6300. Accordingly, courts have granted plaintiffs relief from automatic stays where they seek to establish liability of debtors solely for purposes of recovering against a surety, insurer or other third party. *See*, for

example, *Mid-Jersey National Bank v. Fidelity Mortgage Investors*, 518 F. 2d 640 (3d Cir. 1975); *In re Traffic Safety Company*, 10 Bankruptcy Reports 751, (E.D. Pa. 1981); *Matter of McGraw*, 18 Bankruptcy Reports 140 (W.D. Wisc. 1982); *Elliott v. Hardison*, supra.

Plaintiff-appellant seeks relief from the automatic stay provision in order to reach defendant-debtors' assets. It is precisely the purpose of Section 362 to defeat such an intent on the part of a creditor. Plaintiff's attempt to institute third-party proceedings against defendant-debtors threatens a substantial portion of the estate's assets. Furthermore, the cost of prolonging litigation in a foreign forum is substantially frustrating debtors' attempt to pay creditors under a Chapter VII plan and, therefore, interferes with creditors receiving payment under such a plan. Therefore the judgment of the Bankruptcy Court will be affirmed.

Would you submit an order?

MR. JURISTA: I will submit an order.

[19] THE COURT: Good. Thank you very much.

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APPENDIX C — ORDER OF THE HON. DICKINSON R. DEBEVOISE, U.S.D.J. FILED OCTOBER 6, 1983

LEHMAN & WASSERMAN
A Professional Corporation
225 Millburn Avenue, P.O. Box 311
Millburn, New Jersey 07041
(201) 467-2700

Filed Oct. 6, 1983
ALLYN Z. LITE, Clerk

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

In the Matter of:

M. FRENVILLE CO., INC., RUDOLPH F. FRENVILLE, JR. and RUDOLPH F. FRENVILLE, SR.,

Debtors.

AVELLINO & BIENES, a Partnership,

Plaintiff-Appellant,

-vs-

M. FRENVILLE CO., INC., RUDOLPH F. FRENVILLE, SR., and CHARLES STANZIALE, ESQ., Interim Trustee.

Defendants-Appellees.

Case No. 83-2810
Civil Action (Hon. Dickinson R. Debevoise)

Appendix C

Sat Below:
Hon. D. Joseph DeVito, Bankruptcy Judge

Bankruptcy Adv. No. 83-0721

This matter having come on before the Court by reason of a Notice of Appeal filed by Avellino & Bienes, plaintiff and appellant herein, and it appearing that plaintiff/appellant herein has appealed an order of the Honorable D. Joseph DeVito, Bankruptcy Judge, entered on June 22, 1983, which Order denied plaintiff/appellant's request for relief from the automatic stay provisions of the Bankruptcy Code, and the Court having considered the Briefs filed in this matter, as well as the oral argument of counsel, Steven Z. Jurista, Lehman & Wasserman, appearing for Defendant/Appellee M. Frenville Co., Inc., et al; Susan M. Moryan, McDonough, Murray & Korn, appearing for Plaintiff/Appellant Avellino & Bienes; and Ben H. Becker, Schwartz, Tobia & Stanziale, appearing for Trustee, and the Court having rendered its decision on the record on September 26, 1983, and good cause appearing for the making of this Order,

IT IS, on this 6th day of October, 1983,

ORDERED, that the decision of the Bankruptcy Court entered on June 22, 1983, be and the same is hereby affirmed for the reasons set forth in this Court's Opinion as stated on the record on September 26, 1983.

DICKINSON R. DEBEVOISE
U.S. DISTRICT JUDGE

APPENDIX D — TRANSCRIPT OF PROCEEDINGS BEFORE THE HON. D. JOSEPH DE VITO, U.S.B.J. FILED FEBRUARY 8, 1983

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY
CASE NUMBER: 82-0958

IN THE MATTER OF M. FRENVILLE,

Debtor.

B E F O R E:

THE HONORABLE D. JOSEPH DE VITO, United States Bankruptcy Court Judge, in Courtroom 6, Federal Courthouse and Post Office Building, Newark, New Jersey, on February 8, 1983 at 12:30 P.M.

1. Adjourned Hearing to Vacate Stay by Avellino and Bienes

A P P E A R A N C E S:

MESSRS. MC DONOUGH, MURRAY & KORN
BY: JAY SCOTT MAC NEIL, ESQ.,
Attorney for Avellino and Bienes

MESSRS. LEHMAN & WASSERMAN
BY: STEVEN Z. JURISTA, ESQ.,
Attorney for Debtor

SCHWARTZ, TOBIA & STANZIALE
BY: BEN H. BECKER, ESQ.,
Attorney for Trustee

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[2] MR. MAC NEIL: This is the return date of the adjourned hearing to vacate stay by Avellino and Bienes pursuant to Section 362 of the United States Bankruptcy Act.

We have with us today one of the senior partners of the New York law firm involved in the litigation in New York where we're seeking to bring the Frenville company's, the Frenville's themselves into that action.

Briefly, the background of the case is this. In July of 1980, an involuntary petition was filed against the Frenville Company's. In January of 1981, a voluntary petition was filed against the two individual Frenville's. In November of 1981, 14 months after the original complaint and about 10 months after the second involuntary petition against the individual and suit was started in the Supreme Court of the State of New York in the County of New York, by the Chase Manhattan Bank. The Fidelity Bank and the Fidelity International and the Gerard Bank, all of them Creditors of the Frenville Company's.

The suit was against Avellino and Bienes who was functioning in '78 and '79 as accountants for the Frenville Company's.

[3] The suit alleges that through reckless, negligence and lack of good accounting principals and other common law theories, Avellino and Beines prepared certified statements which were relied upon by each of the individual banks to various degrees.

They're alleging the total addendum clause, approximately 11 million dollars. The defendants, Avellino and Bienes says that we weren't negligent. What happened was that the information that we obtained from the company, the Frenville's and the Frenville Company's, it was either negligently prepared and controlled, or there was fraud, one or the other.

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THE COURT: You mean by internal accounting —

MR. MAC NEIL: By internal accounting or manipulation, the principals themselves through the use of moving inventory around or misstating accounts receivables or what have you and Avellino and Bienes is looking at a 7 to 11 million dollars suit depending on whose number you read, and there, the Frenville's, in that suit, because it has to defend on the basis of the fact that the information was only as good as what it got from these bankrupts.

[4] Now, the stay that was imposed, the interesting language of it is, that it would stay proceedings that were, or could have been commenced before the commencement of the case under this title.

Now, there is no way that Avellino and Bienes could have commenced a claim against the Frenville Company's for negligence, fraud, or any other reasons before they filed a bankruptcy petition, because there would have existed no cause of action since the bank apparently had not called a loan, or whatever and there was no claim of fraud or negligence on the part of the defendants, Avellino and Bienes and be the fraud that came to light came to light only when the extent of the liability and what really went on was discovered post-petition. So, we're not talking about the normal continuation of a lawsuit or the continuation of a claim that existed prior to bankruptcy. The claim and the cause of action arose only post-petition and that if we did, had we known —

THE COURT: The underlying facts didn't occur.

MR. MAC NEIL: The underlying facts preceded the petition. But, the underlying facts were incapable of discovery until the

claim arose that [5] the bank said, you negligently prepared it or you defrauded us. At that time, it was the first time that we knew that there was a claim against us and even though the facts preceded the petition, the claim did not.

Now, it's also our position that in a peculiar sense, assuming that we filed, assuming that we filed nothing in this Court, technically we're in the State Court of New York and we're going to have to defend this case by saying that it wasn't us. It was somebody else that really did it.

Trial tactics dictate that the phantom defendant is a very weak defendant. It would be no way for that Court in New York to apportion between two possibly equally guilty defendants, the extent of the liability. So that what could happen is, we would then have a trial in New York where we would be assessed liable, conceivably. We would then have to turn around and we have filed in this case a proffer of claim for 11 million dollars and come in here and try it. That duplicates the necessity of proof, number one, but in addition to that you get back into the Marathon problem that Mr. Sturtz just raised in the prior case involving what the Supreme Court said, because then you're going to try a fraud [6] case, a real common law theory of negligence and fraud in this Court all over again, when Avellino had to come in appearing again, the Frenville Company and the principals seeking to determine the extent to which they would be responsible for any portion of that claim in New York.

The New York practice permits us as does New Jersey practice to bring in the purportedly copable co-defendants, during the proceedings.

During the proceedings that is pending, rather than await a judgment to come forward and then, start another lawsuit. That

is all we're seeking to do here, is have them in the New York Courts so that that Court having jurisdiction can determine the percentages to which either of the defendants is responsible.

The State here would not be prejudiced because in the event that we were successful in showing that the bulk of the liability indeed fell on the Frenville Company's or the individual Frenville's before anything happened, Chase or us would have to come back to this Court seeking a lifting of a stay to execute the judgment we had and go through a proceeding here to determine where we stood in the parade of Creditors that are no doubt, amazing, in [7] the Frenville case.

So I think, that fairness would dictate if nothing else, that the stay be lifted to permit us to have the jurisdiction of the Court of New York asserted and to have a determination in that proceeding as to the extent of the liability within the two defendants there.

In addition to which it's our position that even though the factual basis for the stay preceded the petition, the knowledge of the claim of the legal basis or any action by anybody was far post-petition and that now we be left in the anonymous position of having no remedy because we could not get them into the New York Court. It would be highly questionable about whether or not this Court would have any jurisdiction to hear such a claim, because of the Marathon Case and the solution we suggest is to permit the stay to be lifted and the proceedings to go forward in New York.

This thing simply seeks service of process on the Frenville's after all of the defenses, legal, equitable, or otherwise that could be asserted in any lawsuit are assertable. There has been no

prejudice to them at this point and indeed they're well aware of the pendency of the litigation. [8] Thank you.

Your Honor, I could produce Mr. Edelman for testimony. The fact that there's pending in New York the Supreme Court, State of New York a suit against his client, individually and as a partnership, if you feel that is necessary.

THE COURT: I don't think so.

MR. JURISTA: I appear for the Frenville's in this matter.

Your Honor, the plaintiff is attempting to establish to this Court, that they're a defendant in a negligence action in the State of New York without, by class I have no quarrel with that. But what they're attempting to do is get the authority of this Court to have my clients named as a third party defendant in that action for contribution or indemnity. In other words, they're found liable, then obviously it had to be a result of my client's negligence and therefore we're liable and we should be named a party defendant.

Now, they are becoming very presumptuous in assuming that if there was any negligence on our part that it would be our client's responsibility, but putting that aside for the moment, your Honor, they're asserting and I would suggest that it's a [9] very narrow reading of Section 362 that the automatic stay provision does not prohibit the continuation of this cause of action because the cause of action arose after the ax proceeding were initiated.

First, let me suggest to your Honor that the scope of the automatic stay is very broad as your Honor well knows and it's the heart and soul of any bankruptcy proceedings. The automatic stay provision is clear. It stays the commencement, continuation of any action whatsoever.

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THE COURT: This is a Chapter 7 matter now. Isn't it?

MR. JURISTA: It is, your Honor. Section 362 B, states the exceptions to the automatic stay provision. The action that plaintiff is attempting to pursue here does not fall within any of the exceptions, does not fall within anywhere near the exceptions. It's an action to have determined any contribution, plan and simply it falls clearly within the scope of Section 362.

Now Section 362 D allows this Court to vacate it's automatic stay for cause. The question of course is whether or not there is sufficient cause to vacate the stay here. What we have here, [10] your Honor, is a contingent claim. It's a claim against our clients which is contingent upon a judgment entered by the plaintiff in the New York action, the Avellino and Bienes accounting firm.

Section 502C, your Honor, which is the Section which provides for the estimation of a contingent claim, may be the remedy available to the plaintiff in this case. I would submit to your Honor, that a similar situation came up in the Borne Chemical matter, a case which your Honor decided a couple years ago, dealing with the rights of stockholders to litigate an action against a Debtor in the State Courts.

I think your Honor issued an opinion in that action which stood for the proposition that allowing Creditors to proceed in the State Court would interfere with the Debtors reorganization and in this case, your Honor, it would interfere with the Debtor's rehabilitation.

THE COURT: The issue in that case was an estimation of the claim that were filed by the litigants in the State Court action.

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MR. JURISTA: It would be our position here that the claims can be estimated in this case as well, your Honor. There is no need for our clients [11] to be named party defendants to that action.

Now Your Honor, the plaintiff cites some case in the brief which were submitted to your Honor, all of which are easily distinguishable. They cite the case of Waynemouth vs. New York. That case deals with a post-petition. It was a Debtor who was involved in an automobile accident after the time that his petition was filed. A cause of action dealt with the factual situation which occurred after the time that the petition was filed.

Here we have a situation where a cause of action arose prior to the time the petition was filed.

THE COURT: When was that brief filed?

MR. MAC NEIL: It was hand delivered to you mid-week, last week.

THE COURT: It's not in the file here. Continue.

MR. JURISTA: The second case that they cite is a case they called in re: Terry, which completely mistates the proposition that Mr. Mac Neil's brief completely mistates the proposition of that case. That case was a situation where a Debtor was a doctor who was involved in a medical malpractice case from botching up a vasectomy and in the State [12] of Wisconsin they had an administrative panel which screened medical malpractice claims. They arose during the so called medical malpractice crisis which occurred during the mid '70's and what that bankruptcy court held was that it was all right for that administrative screening

panel to decide whether or not there was a cause of action. It did not allow the Court proceedings to continue.

Third case which Mr. Mac Neil cites is a case called in re: Decortier. In any event, that was a case under the old Bankruptcy Act where it was strictly a contingent claim, and the matter was set for trial in the State Court shortly after the time the petition was filed and the Bankruptcy Court took the position that since the claim was a contingent claim under the old Act and had to be defined in a specific number, there was no reason why that State Court action shouldn't proceed. It has absolutely no basis with regard to the matter before the Court today. This is an action for indemnity. It's an action for contribution. It's an action similar to an action on a guarantee and there is absolutely no basis whatsoever to vacate the automatic stay to proceed against these clients. It's a case which clearly goes to the heart of the [13] automatic stay provision and my clients should not be allowed to be made a party defendant to an action in the State Court of New York, nor should they be allowed to be made a party defendant in any other action besides this one.

THE COURT: Why not?

MR. JURISTA: Because your Honor, because they filed the petition with this Court or rather there was an involuntary petition filed against them in the Court. They're entitled to a discharge pending a hearing on that discharge there is no reason they should be allowed to litigate any potential claims against them in another forum. That is what the stay is all about.

THE COURT: I know that is what the stay is all about. You said it's going to interfere with the continuance or the commencement of an action in another Court but this ultimately,

whether the issue is decided here or in the State Court is going to rely upon the issue of distinguishability of the defendants. If they're successful you've got a situation.

MR. BECKER: Your Honor, Ben Becker. I represent the Trustee. The Trustee is also named in the complaint and proceedings against the Trus-[14]tee M. Frenville Company, Inc. Mr. Stanziale is the Trustee over the individual defendants.

THE COURT: Why is the Trustee named?

MR. MAC NEIL: Your Honor, after the last hearing, we really got everybody involved that we could, because we think, well, the Trustee has control of the estate, also and I think that the Trustee probably —

MR. BECKER: I think that the Trustee is properly named, your Honor. But, I would like to address your Honor's question as to why they shouldn't be allowed to proceed. First of all, it's obvious why they want us in the case. They want us in the case in New York so they have somebody to point a finger at. So, it's always easier to try a case if you're in a position as a defendant where there's somebody else to put the blame on.

As a practical matter, they have another solution to that problem.

THE COURT: Let me ask you this for a moment. Are you people the target of that third party complaint?

MR. MAC NEIL: The purpose is, your Honor, that either it was fraud on their part and we claim it was fraud.

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[15] THE COURT: You're talking about the Frenville's?

MR. MAC NEIL: Yes. We're the target of the complaint in New York but we really think it ought to be the Frenville's.

THE COURT: You're going to bring them in by way of a third party complaint?

MR. BECKER: Chase is also pursuing them, based on the alleged malpractice. They want a finger to point out as a practical matter. If they want the Frenville's individually in this suit and they want their testimony, they have the power of subpoena. They, not having them as parties, doesn't prevent them from bringing them into the litigation of course. They'll be faced with the same problem that we have had in the bankruptcy court, which is, they probably won't answer any questions. They'll take the Fifth Amendment. But, that is going to be the case whether they are a party or not, a party to this suit.

Mr. Jurista can probably speak to that point better than I.

THE COURT: He's spoken to me on several occasions. He keeps repeating that tactic.

MR. BECKER: The second problem is addressing the practicality, is one of the problems of the stay [16] in Chapter 7 or 11, is to avoid a burden to the estate. Despite the fact that there is an enormous amount of litigation surrounding this estate, we're dealing with very small estates, M. Frenville, the entire estate is approximately $40,000. Rudolph Frenville, Jr., I believe, the estate is in the amount of approximately $15,000. We're talking about bringing the Frenville's into New York to defend litigation involving a 7 million dollar claim, plus by the bank.

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THE COURT: I have sympathy for the Trustee being dragged over there as a party defendant. I don't necessarily have the same sympathy for the litigants.

MR. BECKER: The question with respect to the litigants is, whether the discharge in bankruptcy or whether the protection of the Bankruptcy Code is for them. But, as far as the Trustee is concerned we'll exhaust what little there is in the estate and unnecessary legal and in addition, you know, we have talked about the issue being the objection to the discharge. I suppose this is also Mr. Jurista's position as well, but, we're beyond the point where an objection to the discharge can be made. There has been no objection to the discharge. With re-[17]spect to asserting a claim against the estate of either the corporation or of the Frenville individual estate, Mr. Mac Neil, I believe, he stated that there was a proof of claim filed. But, I suspect that it was filed after the deadline for filing proof of claim. Certainly with respect to M. Frenville Company, Inc., case and I suspect also with respect to the individuals. So, where they're going, I don't know. I think at this point, particularly balancing the equities and I think the Court has to balance equities in deciding the relief of the stay to pull a Trustee into a New York litigation.

THE COURT: I have reservations about that. In order to defend what really isn't what ultimately will not really benefit them in any significant way, if they get hit they're going to get hit big. If they get hit for 7 million it's a possibility that they may have their share of a $40,000 estate, frankly is not that important.

MR. MAC NEIL: Your Honor, quite frankly, both of these gentlemen have put their finger on one of the problems. Before the petition was filed, what could we have done? We had nothing.

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There was no claim by the bank against us, nor was there [18] a claim by the bank against anybody. Finally, when the realization occurred that these people are really in severe financial condition, involuntary petitions were filed. But, it wasn't until 14 months later that they swung the gun around and looked at us and said, because of your negligence in certifying the reports, because which is a particular typical situation we put out $5,000 on the part of Chase and so the claim is up to 11 million.

Now, if we cannot get the Frenville's in there to defend and to come forward and have an allocation between the two of us, we're literally in a position of having no remedy. We couldn't have filed the prior petition. There was nothing pending. Now they're saying, we can't file post-petition and bring them in because of the stay. There is a probability we can or at least a possibility that we can discover and show fraud in this case.

If that is so, that maybe a non-dischargable situation and a judgment rendered against the Frenville's may be good for 20 years in this state.

Now frankly, because of the occurrence of 14 months lapse in between the date of the filing of the involuntary petition against Frenville and [19] the time we were first notified of the pendency of a claim in New York, we may well have been outside the time for dischargability but we still have a right to come to this Court and petition this Court to challenge the dischargability of that debt if indeed we're found responsible and they're found responsible and the basis of their responsibility is fraud. If we can show fraud we can come back here and we can say that we didn't know until 14 —

THE COURT: That is another day.

MR. MAC NEIL: That is true. It's another day but what we're seeking, we're seeking an opportunity to have the adjudication paid in the proper form in a pending action. We think that the Frenville's ought to be there and the stay, if it exists at all, ought to be lifted.

MR. JURISTA: Your Honor —

THE COURT: Very quickly, gentlemen. It's now quarter after one and I have been sitting here since 9:00.

MR. JURISTA: We do have the power of subpoena. It's an action for contribution. It's a similar situation as if a bank was sueing two guarantors. I don't know one guarantor was a debtor [20] in a bankruptcy proceeding and the suit against the second guarantor, that guarantor seeks authority to bring the other guarantor who was the Debtor in the bankruptcy proceedings.

THE COURT: It's not an improper procedure.

MR. JURISTA: But, is there a basis? It's no basis. It's a section for contribution on what may very well be a dischargable debt. They haven't indicated anything to your Honor to prove that there would be a basis for discharge, non-dischargability as Mr. Becker said, that time may have long since past, but, to bring this Debtor into a proceeding in New York and have him defend himself in an action in New York while he is in a bankruptcy proceeding and under the jurisdiction of this Court, I think goes against the very heart and nature of the Bankruptcy Code.

THE COURT: Okay. I have heard enough.

MR. MAC NEIL: Just for the record, we don't believe we do have the power of subpoena. It's a New York State Court

action. It would be very difficult to get the power of subpoena to bring it that way.

THE COURT: I'll reserve.

(Whereupon hearing is concluded.)

[21] C E R T I F I C A T E

I, EUNICE TAYLOR, a Shorthand Reporter of the State of New Jersey, do hereby state that the foregoing is a true and accurate transcript of my stenographic notes of the within proceedings, to the best of my ability.

s/ Eunice Taylor
EUNICE TAYLOR

APPENDIX E — OPINION AND ORDER OF THE HON. D. JOSEPH DE VITO, U.S.B.J. FILED JUNE 22, 1983

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

No. 82-0958

In the Matter of

M. FRENVILLE CO., INC., RUDOLPH F. FRENVILLE, SR. and RUDOLPH F. FRENVILLE, JR.,

Debtors

AVELLINO & BIENES, a Partnership,

Plaintiff,

vs.

M. FRENVILLE CO., RUDOLPH FRENVILLE, SR., and CHARLES STANZIALE, ESQ., Interim Trustee,

Defendants.

DE VITO, JUDGE

Avellino & Bienes (AB), a partnership, plaintiff in the above captioned matter, seeks modification of the automatic stay allowing it to serve process on the debtors in a New York state court proceeding.

The following facts are undisputed.

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1. AB, an accounting firm, performed services for M. Frenville Company, Inc. (MFC) sometime after 1977

2. In July, 1980, an involuntary petition was filed against MFC pursuant to Chapter 7 of the Bankruptcy Code. In January, 1981, involuntary petitions were similarly filed against Rudolph Frenville, Sr. and Rudolph Frenville, Jr., principals of MFC and hereinafter collectively referred to as the debtors.

3. In November, 1981, AB was named as defendant in a New York Supreme Court action, wherein plaintiff banks, non-parties to these proceedings, alleged AB's negligent preparation of MFC's financial statements.

4. AB seeks to join the debtors as third-party defendants in the New York action under a claim for indemnity and contribution. AB's claim is based upon alleged pre-petition acts of the debtors.

AB first argues that the automatic stay does not apply on the facts at bar, since the state court action was commenced post-petition.

Plaintiff's argument fails to consider the clear language of §362[a] of the Code, which provides:

> [a] Except as provided in subsection [b] of this section, a petition filed under section 301, 302, or 303 of this title operates as a stay, applicable to all entities, of -
>
> > [1] the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or

> other proceeding against the debtor that was or *could have been* commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title; (Emphasis added.)

The legislative history of that section reveals that

> [s]ection 362[a][1] of the House amendment adopts the provision contained in the Senate amendment enjoining the commencement or continuation of a judicial, administrative, or other proceeding to recover a claim against the debtor that arose before the commencement of the case.

124 Cong. Rec. H 11,092 (Sept. 28, 1978); S 17,409 (Oct. 6, 1978).

Since AB's claim for indemnification is based upon the debtors' act occurring prior to the filing of the involuntary petitions, the action "arose before commencement of the case" and is subject to the stay.[1]

Counsel argues alternatively that the stay should be lifted because:

1. "its [sic] unjust and unfair to permit" the state court action to proceed against B only; and

---

1. The case plaintiff cites is inapposite to the instant case, as the claim pursued by the plaintiff therein was based upon a post-petition occurrence. *In re York*, 13 B.R. 757, 7 BCD 1311, 5 CBC 2d 132 (Bankr. D. Maine 1981).

2. estimation of the plaintiff's claim against the debtors "would be extraordinarily difficult," and "can be dealt with more effectively in the state court action . . ." Pl. Br. at pgs. 5, 6.

For the reasons set forth, the Court finds plaintiff's argument to be without merit.

In support of its claim that the debtors' liability to AB can be dealt with more effectively in the state court, the plaintiff cites *In re Terry,* 12 B.R. 578, 7 B.C.D. 1218, BLD ¶68285 (Bankr. E.D. WI. 1981). *Terry* involved a Chapter 13 debtor, a defendant before a state statutory medical malpractice compensation panel. The court vacated the stay only to permit the panel to make findings and an award.

The case at bar is distinguishable from *Terry, supra* in that the debtors are not sought to be joined as co-defendants but rather as third-party defendants, with the debtors' liability contingent upon the third-party plaintiff's liability to another. Further, *Terry* involved an informal proceeding in the debtor's home forum; whereas AB seeks to subject the debtors to a plenary trial in a foreign forum necessitating the retention of counsel therein and the resulting expenses and delays.

In weighing the improbable benefit to the plaintiff against the expense, inconvenience, and delay in the administration of the estate, the Court concludes that the debtors have carried their burden of proof in challenging the alleged cause.

Wherefore, it is hereby ordered that plaintiff's prayer for relief be denied.

D. JOSEPH DE VITO
Bankruptcy Judge

Dated: June 22, 1983
Newark, New Jersey

APPENDIX F — COMPLETE TEXT OF SECTION 362 OF THE BANKRUPTCY CODE, 11 U.S.C. §362

BANKRUPTCY CODE

SECTION 362 (11 U.S.C. §362)

§ 362 Automatic stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 (15 U.S.C. 78eee(a)(3)), does not operate as a stay—

(1) under subsection (a) of this section, of the commencement or continuation of a criminal action or proceeding against the debtor;

(2) under subsection (a) of this section, of the collection of alimony, maintenance, or support from property that is not property of the estate;

(3) under subsection (a) of this section, of any act to perfect an interest in property to the extent

that the trustee's rights and powers are subject to such perfection under section 546(b) of this title;

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(6) under subsection (a) of this section, of the setoff by a commodity broker, forward contract merchant, stockbroker, or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts, as defined in section 761(4) of this title, forward contracts, or securities contracts, as defined in section 741(7) of this title, that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741(5) or 761(15) of this title, or settlement payment, as defined in section 741(8) of this title, arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or other property held by such commodity broker, forward contract merchant, stockbroker, or securities clearing agency to margin, guarantee, or secure commodity contracts, forward contracts, or securities contracts;

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(7) under subsection (a) of this section, of the commencement of any action by the Secretary of Housing and Urban Development to foreclose a mortgage or deed of trust in any case in which the mortgage or deed of trust held by said Secretary is insured or was formerly insured under the National Housing Act and covers property, or combinations of property, consisting of five or more living units; or

(8) under subsection (a) of this section, of the issuance to the debtor by a governmental unit of a notice of tax deficiency.

(c) Except as provided in subsections (d), (e), and (f) of this section—

(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and

(2) the stay of any other act under subsection (a) of this section continues until the earliest of—

(A) the time the case is closed;

(B) the time the case is dismissed; and

(C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, or 13 of this title, the time to discharge is granted or denied.

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or

(2) with respect to a stay of an act against property, if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

(e) Thirty days after a request under subsection (d) of this section for relief from the stay of any act against property of the estate under subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the court, after notice and a hearing, orders such stay continued in effect pending, or as a result of, a final hearing and determination under subsection (d) of this section. A hearing under this subsection may be a preliminary hearing, or may be consolidated with the final hearing under subsection (d) of this section. If the hearing under this subsection is a preliminary hearing—

(1) the court shall order such stay so continued if there is a reasonable likelihood that the party opposing relief from such stay will prevail at the final hearing under subsection (d) of this section; and

(2) such final hearing shall be commenced within thirty days after such preliminary hearing.

(f) The court, without a hearing, shall grant such relief from the stay provided under subsection (a) of this section as is necessary to prevent irreparable damage to the interest of an entity in property, if such interest will suffer such damage before there is an opportunity for notice and a hearing under subsection (d) or (e) of this section.

(g) In any hearing under subsection (d) or (e) of this section concerning relief from the stay of an act under subsection (a) of this section—

(1) the party requesting such relief has the burden of proof on the issue of the debtor's equity in property; and

(2) the party opposing such relief has the burden of proof on all other issues.

APPENDIX G — COMPLETE TEXT OF SECTION 502 OF THE BANKRUPTCY CODE, 11 U.S.C. §502

SECTION 502 (11 U.S.C. § 502)

§ 502 Allowance of claims or interests.

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

(b) Except as provided in subsections (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

(1) such claim is unenforceable against the debtor, and unenforceable against property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;

(2) such claim is for unmatured interest;

(3) such claim may be offset under section 553 of this title against a debt owing to the debtor;

(4) if such claim is for a tax assessed against property of the estate, such claim exceeds value of the interest of the estate in such property;

(5) if such claim is for services of an insider or attorney of the debtor, such claim exceeds the reasonable value of such services;

(6) the claim is for a debt that is unmatured on the date of the filing of the petition, and that is excepted from discharge under section 523(a)(5) of this title;

(7) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds—

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—

(i) the date of the filing of the petitioner; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates;

(8) if such claim is for damages resulting from the termination of an employment contract, such claim exceeds—

(A) the compensation provided by such contract, without acceleration, for one year following the earlier of—

(i) the date of the filing of the petition; and

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(ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus

(B) the unpaid compensation due under such contract without acceleration, on the earlier of such dates; or

(9) such claim results from a reduction, due to late payment, in the amount of an otherwise applicable credit available to the debtor in connection with an employment tax on wages, salaries, or commissions earned from the debtor.

(c) There shall be estimated for purpose of allowance under this section—

(1) any contingent or unliquidated claim, fixing or liquidation of which, as the case may be, would unduly delay the closing of the case; or

(2) any right to an equitable remedy for breach of performance if such breach gives rise to a right to payment.

(d) Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522(f), 522(h), 544, 545, 547, 548, 549, or 724(a) of this title, unless such entity or transferree has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522(i); 542, 543, 550, or 553 of this title.

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(e)(1) Notwithstanding subsections (a) and (b) of this section and paragraph (2) of this subsection, the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on, or has secured, the claim of a creditor, to the extent that—

(A) such creditor's claim against the estate is disallowed;

(B) such claim for reimbursement or contribution is contingent as of the time of allowance of such claim for reimbursement or contribution; or

(C) such entity requests subrogation under section 509 of this title to the rights of such creditor.

(2) A claim for reimbursement or contribution of such an entity that becomes fixed after the commencement of the case shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) of this section, the same as if such claim had become fixed before the date of filing of the petition.

(f) In an involuntary case, a claim arising in the ordinary course of the debtor's business or financial affairs after the commencement of the case but before the earlier of the appointment of a trustee and the order for relief shall be determined as of the date such claim arises, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

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(g) A claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(h) A claim arising from the recovery of property under section 522(i), 550, or 553 of this title shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(i) A claim that does not arise until after the commencement of the case for a tax entitled to priority under section 507(a)(6) of this title shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) or (e) of this section, the same as if such claim had arisen before the date of the filing of the petition.

(j) Before a case is closed, a claim that has been allowed may be reconsidered for cause, and reallowed or disallowed according to the equities of the case.

APPENDIX H — AMENDED COMPLAINT FILED BY CHASE MANHATTAN, ET ALS. AGAINST RESPONDENTS

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

Index No.

THE CHASE MANHATTAN BANK, N.A., THE FIDELITY BANK, FIDELITY INTERNATIONAL BANK and GIRARD INTERNATIONAL BANK,

Plaintiffs,

-against-

AVELLINO & BIENES, a partnership, FRANK AVELLINO, and MICHAEL BIENES,

Defendants.

Plaintiffs, by their attorneys, Milbank, Tweed, Hadley & McCloy, for their amended complaint allege:

1. Plaintiff The Chase Manhattan Bank, N.A. ("Chase") is, and was at all times described herein, a national banking association organized and existing under the laws of the United States of America. Chase maintains its principal place of business at 1 Chase Manhattan Plaza, New York, N.Y.

2. Plaintiff The Fidelity Bank ("Fidelity") is, and was at all times described herein, a banking institution organized and existing under the laws of the Commonwealth of Pennsylvania. Fidelity maintains its principal place of business at Broad & Walnut Streets, Philadelphia, Pa.

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3. Plaintiff Fidelity International Bank ("Fidelity International") is, and was at all times described herein, a corporation organized and existing under the laws of the United States of America. Fidelity International maintains its principal place of business at 99 William Street, New York, N.Y.

4. Plaintiff Girard International Bank ("Girard") is, and was at all times described herein, a corporation organized and existing under the laws of the United States of America. Girard maintains its principal place of business at 67 Wall Street, New York, N.Y.

5. Defendant Avellino & Bienes ("A&B") is, and was at all times described herein, a partnership engaged in the practice of public accountancy. A&B maintains its principal place of business at 535 Fifth Avenue, New York, N.Y.

6. Defendants Frank Avellino and Michael Bienes are, and were at all times described herein, partners in A&B and certified public accountants licensed to practice in the State of New York.

7. From September 1, 1977 until May 1, 1980, and for some time thereafter, A&B was engaged by M. Frenville Co., Inc. ("Frenville"), a corporation organized and existing under the laws of the State of New Jersey, as Frenville's independent accountant and auditor.

8. As Frenville's independent accountant and auditor, A&B was required to examine, audit and verify Frenville's financial statements for the years ended August 31, 1978 and August 31, 1979.

9. On or about November 15, 1978, A&B issued a set of certified financial statements of Frenville (the "1978 Report"),

including a balance sheet as of August 31, 1978, and a related statement of income for the year ended August 31, 1978. The following opinion of A&B accompanied the 1978 Report:

> We have examined the balance sheet of M. Frenville Co. Inc. as of August 31, 1978, and the related statement of income for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.
>
> In our opinion, the aforementioned financial statements present fairly the financial position of M. Frenville Co. Inc. at August 31, 1978, and the results of its operations for the year then ended, in conformity with generally accepted accounting principles consistently applied.

10. On or about December 3, 1979, A&B issued a set of certified financial statements of Frenville (the "1979 Report"), including a balance sheet as of August 31, 1979 and August 31, 1978, and related statements of income and changes in financial position for the years ended August 31, 1979 and August 31, 1978. The following opinion of A&B accompanied the 1979 Report:

> We have examined the balance sheet of M. Frenville Co., Inc. as of August 31, 1979 and 1978, and the related statements of income and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and

> accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.
>
> In our opinion, the aforementioned financial statements present fairly the financial position of M. Frenville Co., Inc. at August 31, 1979 and 1978, and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied.

11. On information and belief, A&B knew when it prepared and issued the 1978 Report and the 1979 Report that Chase, Fidelity, Fidelity International and Girard (collectively, the "Banks"), or members of a fixed and definable group that included the Banks, would rely upon the 1978 Report and the 1979 Report and the accompanying opinions of A&B.

12. On information and belief, A&B and Frenville understood and agreed that A&B would prepare and issue the 1978 Report and the 1979 Report, and express written opinions regarding them, for the use and benefit of the Banks, or of an unspecified group of creditors that later became identified as the Banks.

13. Each of defendants acted negligently and recklessly in preparing and issuing the 1978 Report and the 1979 Report and in expressing the opinions accompanying them.

14. In preparing and issuing the 1978 Report and the 1979 Report and in expressing the opinions accompanying them, each of defendants negligently and recklessly failed to comply with generally accepted auditing standards of the accounting profession.

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15. The negligent and reckless conduct of defendants in preparing and issuing the 1978 Report and the 1979 Report, and in expressing the opinions accompanying them, included the following:

(a) Defendants failed to conduct a proper study and evaluation of the plan of organization, procedures and records of Frenville that were concerned with the safeguarding of assets and the reliability of financial records. These internal accounting controls were insufficient to provide reasonable assurance that, among other things, records were maintained and procedures were performed to ensure accountability for assets and the reliability of financial records.

(b) Defendants knew or should have known that officers or employees of Frenville performed incompatible accounting functions that placed them in a position to perpetrate and conceal material errors and irregularities, yet did not perform auditing procedures designed to detect such errors and irregularities.

(c) Defendants did not obtain sufficient confirmation of accounts receivable, or perform other requisite auditing procedures, to ensure that the 1978 Report and the 1979 Report fairly presented the amounts of Frenville's accounts receivable.

(d) The amounts allocated as allowances for doubtful accounts in the 1978 Report and the 1979

Report were arbitrarily determined without factual support.

(e) Defendants' did not adequately observe Frenville's inventory, or perform other requisite auditing procedures, to ensure that the 1978 Report and the 1979 Report fairly presented the amounts of inventory.

(f) Defendants failed adequately to investigate, determine and disclose the nature and extent of Frenville's transactions with affiliated enterprises, and to investigate and determine the reliability of records pertaining to such transactions.

(g) Defendants failed properly to supervise and review the work of its employees in connection with the preparation of the 1978 Report and the 1979 Report.

16. As a result of defendants' negligent and reckless conduct, the 1978 Report and the 1979 Report described the financial position of Frenville, the results of its operations and the changes in its financial position in false and materially misleading terms, and the representations made by A&B in the opinions accompanying those reports were false and materially misleading.

17. From time to time after November 15, 1978, each of the Banks extended credit and other financial accommodations to Frenville in reliance upon the 1978 Report and the accompanying opinion of A&B.

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18. From time to time after December 3, 1979, each of the Banks extended credit and other financial accommodations to Frenville in reliance upon the 1979 Report and the accompanying opinion of A&B.

19. As a result of these extensions of credit in reliance upon the 1978 Report, the 1979 Report and the accompanying opinions of A&B, on May 1, 1980, Frenville was indebted to each of the Banks in the following aggregate principal amounts, plus accrued interest:

Chase	$5,375,100.08
Fidelity	192,132.10
Fidelity International	1,307,857.30
Girard	1,045,755.87

20. Each of the Banks has a perfected, continuing lien and security interest in all of Frenville's personal property, fixtures and their proceeds, wherever located and whenever acquired, to secure payment of Frenville's indebtedness.

21. In accepting and continuing to accept their respective security interests as adequate for repayment of Frenville's oustanding indebtedness and subsequent extensions of credit, the Banks relied upon the 1978 Report, the 1979 Report and the opinions of A&B accompanying them.

22. Frenville has failed upon demand to pay its indebtedness to the Banks. Frenville is thereby in default of agreements with the Banks governing its indebtedness and the Banks' security interests.

23. On July 7, 1980, an involuntary petition for relief under Chapter 7 of the Bankruptcy Code was filed against Frenville

in the United States Bankruptcy Court for the District of New Jersey. On July 24, 1980, that court entered an order for relief under Chapter 7 of the Bankruptcy Code.

24. Frenville has not paid and will be unable to repay its total indebtedness to the Banks. The property of Frenville in which the Banks have their respective security interests is and will be insufficient to discharge Frenville's total secured indebtedness to the Banks.

25. On information and belief, after issuing the 1978 Report and again after issuing the 1979 Report, defendants became aware of information that materially affected the reliability of those reports and the accompanying opinions of A&B. Despite such awareness, defendants negligently and recklessly failed to advise the Banks:

> (a) that the 1978 Report or the 1979 Report was or may have been false and materially misleading;
>
> (b) that the Banks should not rely upon the 1978 Report or the 1979 Report; or
>
> (c) that the opinions of A&B accompanying the 1978 Report and the 1979 Report were withdrawn, modified or qualified in any way.

26. As a result of defendants' negligent and reckless conduct, Chase, Fidelity, Fidelity International and Girard have suffered and will suffer the loss of funds lent to Frenville, and income thereon, which they have been and will be unable to collect, by reason of the insolvency of Frenville and the non-existence of

collateral which the 1978 Report and the 1979 Report represented to exist.

27. As a further result of defendants' negligent and reckless conduct, Chase, Fidelity, Fidelity International and Girard have expended and will expend substantial sums to locate and obtain assets to satisfy Frenville's indebtedness.

WHEREFORE, Chase, Fidelity, Fidelity International and Giarard demand judgment against defendants jointly and severally as follows:

(a) for damages in favor of Chase in an amount yet to be determined, but at present estimated to be $7,500,000, together with interest thereon;

(b) for damages in favor of Fidelity in an amount yet to be determined, but at present estimated to be $300,000, together with interest thereon;

(c) for damages in favor of Fidelity International in an amount yet to be determined, but at present estimated to be $2,000,000, together with interest thereon;

(d) for damages in favor of Girard in an amount yet to be determined, but at present estimated to be $1,500,000, together with interest thereon;

(e) for the costs, disbursements and attorneys' fees incurred by plaintiffs in connection with this action;

(f) for such other and further relief as to the Court may seem just and proper.

Dated: New York, N.Y.
November 16, 1981

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